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TAGS: EFIN NI
SUBJECT: Nigerian Banking Reform - CBN Encourages
Acquisition of Nigerian Banks

¶1. Summary. On July 6 the governor of the Central Bank of Nigeria (CBN), Charles Soludo, proposed several reforms to the banking sector, the most important of which is raising the capital requirement of banks from naira 2 billion (USD 15 million) to naira 25 billion (USD 189 million) effective December 31, 2005. While his proposal has generated mixed reactions in financial circles and among the public, the CBN is seeking support from the banking community and multilateral financial and donor agencies. The CBN is also encouraging the foreign banks operating in the country to acquire banks that are up for acquisition. It is not clear which, if any, banks will take up this challenge. End summary.

CBN Meets With Diplomatic Community

¶2. On August 11 the CBN, led by its governor, Professor Charles Soludo, briefed heads of diplomatic missions, and representatives of multilateral financial and donor agencies on proposed reforms in the Nigerian banking sector. Soludo asserted that the overall health of the Nigerian banking system is generally satisfactory, but the state of some banks is cause for concern. Specifically, as of April 2004, the CBN's ratings of Nigeria's 89 banks classified sixty-two as sound, fourteen as marginal, eleven as unsound (and two as dormant). He affirmed that the CBN is pursuing the reforms to prevent the boom and bust cycle of the banking sector characteristic of Nigeria's banking history.

Background to the Reforms

¶3. Ignatius Imala, Director of Banking Supervision, confirmed that the Nigerian banking sector needs reform. He said that while the top ten banks account for 50 percent of the industry's assets and liabilities, the end of March 2004 review had revealed that 17.6 percent of total bank deposits were at risk and 19.6 percent of total bank assets were equally so. CBN's total exposure to the banks was naira 71.366 billion (USD 537 million) as of July 2004.

¶4. The Nigeria Deposit Insurance Corporation (NDIC) 2003 review of the banking industry also revealed a deteriorating trend in the quality of risk assets of insured banks. Non-performing loans and advances had totaled naira 135.7 billion in 2001 and naira 199.6 billion in 2002, but the volume rose to naira 260.2 billion by the end of 2003. The ratio of non-performing loans to total loans had been 16.9 percent in 2001, 21.3 percent in 2002, and further increased to 21.6 percent in 2003. The ratio of non-performing loans to shareholders' funds had been 77.1 percent in 2001, 85.9 percent in 2002, and further deteriorated to 89.7 percent in ¶2003.

¶5. Imala had noted that most of Nigeria's banks are small, their capital base averaging naira 1.3 billion (USD 10 million). Insolvency, poor credit policies and administration including excessive risk taking, weak corporate governance and ethical misconduct, and closed ownership structure characterize the unsound banks.

¶6. Imala also confirmed that the CBN hopes that its proposed reform measures will help create a sound banking system that depositors can trust, create banks that are investor friendly and can finance capital intensive projects, enhance corporate governance and accountability, drive down the cost structure of banks, and help banks meet the challenges of globalization, all of which could prevent a systemic crisis.

The Reform Agenda

¶7. Imala confirmed that the reform program is anchored on thirteen points, among which are:

- a minimum capital base requirement of naira 25 billion to be met by December 31, 2005. The capital base is defined as paid-up capital and reserves unimpaired by losses. The

reserves must exclude asset revaluation surpluses resulting from revaluation in the course of consolidation, while paid-up capital is defined as ordinary shares plus non-redeemable preference shares;

- consolidation of banks through mergers and acquisitions;
- adoption of a risk-focused and rules-based regulatory framework;
- zero tolerance for weak corporate governance, misconduct and lack of transparency;
- establishment of an asset management company to manage the CBN's exposure to the banking sector;
- accelerated completion of the electronic Financial Analysis and Surveillance System (e-FASS), to ease the submission of returns by banks and enhance CBN's surveillance capacity;
- strict enforcement of contingency planning for systemic bank distress;
- revision and update of relevant laws and drafting of new ones;
- closer collaboration with the Economic and Financial Crimes Commission's (EFCC) Fraud Investigation Unit and enforcement of the anti-money laundering and other economic crimes measures;
- enforcement of dormant laws, such as the Dud Checks Act;
- review of monetary policy; and
- reorganization of the Nigerian Security Minting and Printing Company (the Mint), to meet the nation's security printing needs as well as those of the west-African sub-region.

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Guidelines, Incentives & Modalities For Consolidation
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¶8. The guidelines announced by the CBN indicate that:

- only mergers and outright acquisitions or takeovers are acceptable. Mere interlinking group arrangements are not allowed. Banks coming together as a group cannot retain their individual brand names, but have to merge under a single brand name.
- All monies toward re-capitalization must be denominated in naira, but can include both ordinary and preferred shares.
- Consideration must be by exchange of shares and not monetary payments, except by dissenting shareholders and provided that payments do not impair the financial condition of the new entity.

¶9. The modalities for consolidation approved by the CBN further stipulate that:

- each party must have a different advisor except where the acquired bank is a wholly-owned subsidiary;
- the board of directors must not exceed 20 members for the consolidated entity; and
- co-chairmen or co-chief executive positions will not be allowed.

¶10. The incentives for mergers announced by the CBN include:

- CBN to provide technical assistance to consolidating banks at no cost;
- possible write-down of CBN's exposure to the acquired unsound bank to make it more attractive;
- tax incentives like capital allowances, companies income tax, stamp duties, etc;
- reduced transaction fees payable to the Securities and Exchange Commission, the Corporate Affairs Commission, the Nigerian Stock Exchange (NSE), and other similar institutions; and
- amnesty for previous misreporting detected in the course of consolidation.

¶11. Banks that attain the new minimum capital base within the stipulated period will be authorized to deal in foreign exchange, granted permission to take public sector deposits and recommended to the fiscal authorities for the collection of public sector revenue, and allowed to manage part of Nigeria's external reserves, subject to prevailing guidelines.

Foreign Banks Should Come

¶12. Soludo invited foreign banks to avail themselves of the opportunities of the reforms by acquiring Nigerian banks. He said the time is right and the startup costs are minimal, because the banks to be acquired already have a countrywide network of branches.

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What Happens To Banks That Do Not Meet the New Capital Requirement?
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¶13. Soludo said the CBN will publish the names of healthy banks on December 31, 2005. Those that do not make the list, because they cannot meet the new recapitalization requirement and are not suitable for mergers or acquisitions, will cease to exist as a result of the public's shunning them. Soludo asserted that he small banks unable to meet the capitalization directive may apply for community bank licenses to serve clients in a limited geographic area.

Is The Reform Sustainable?

¶14. Soludo said the sustainability of the proposed reforms will depend on the level of success achieved. If they s succeed, the public will support them irrespective of the government in power. Soludo is convinced that the reforms will stand the test of time.

Comment

¶15. The CBN's incentives for consolidating the banking sector show that it took some of the earlier criticism of the reform measures into consideration. But the Senate Committee on Finance has expressed reservation and intends to hold hearings, after which it may propose a bill to amend the act of 1991 that governs the Central Bank. Meanwhile, it remains to be seen whether its proposed incentives will induce foreign banks to invest in Nigeria, a country characterized by macroeconomic instability and frequent policy reversals, though opportunities for high returns abound. End comment.

CAMPBELL